

REBUTTAL TESTIMONY OF J. THOMAS O'BRIEN

BACKGROUND

Q. Please state your name, title and business address.

A. J. Thomas O'Brien, Executive Director-Regulatory Affairs,
Ameritech Illinois, 225 W. Randolph Street, HQ27C,
Chicago, Illinois 60606

Q. Are you the same J. Thomas O'Brien who previously filed
direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the
comments of ICC Staff and others regarding the operation
of the Alternative Regulatory Plan (hereafter, the
"Plan"). I will present some further revisions to the
Plan proposed by Ameritech to address some of the
concerns raised by the Illinois Commerce Commission Staff
and intervenors (GCI) in their direct testimony.
Specifically, I propose to remove service quality from
the Plan and address service quality with a separate
mechanism. I also describe how such a mechanism should

function. This and other changes that I am proposing are shown in Schedule 1 (an updated version of the Schedule 1 attached to my direct testimony) which shows the revisions to Appendix A of the first Alternative Regulatory Order in legislative style.

SERVICE QUALITY

Q. What aspects of service quality will you address in your rebuttal testimony?

A. I will respond to the proposals of Staff witness Jackson and GCI witness TerKeurst regarding changes to the treatment of service quality under the Alternative Regulation Plan. Mr. Hudzik will provide specific details that support Ameritech Illinois' proposal.

Q. What is the statutory objective for an Alternative Regulation Plan with respect to service quality?

A. A plan is in the public interest to the extent it "will maintain" service quality.

Q. What does "maintain" mean, in that context?

A. I am not an attorney. However, in terms of ordinary English, "maintain" is defined as "to keep in an existing

state (as of repair, efficiency or validity)." Webster's Ninth New Collegiate Dictionary 718 (1989).

Q. How did the Commission apply that standard in Docket 92-0448?

A. As noted in Mr. Gebhardt's testimony, consistent with the ordinary meaning of the word "maintain," the Commission adopted service quality benchmarks based on Ameritech Illinois' actual performance for seven of the eight measures, in which Ameritech Illinois' performance was consistent with the Commission's generally applicable service quality rules. The Commission did so by averaging Ameritech Illinois' performance for the two years prior to the consideration of the plan, 1990 and 1991. The exception was out of service over 24 hours. There, the Commission applied the standard in the Commission's rules, because actual performance fell short of that standard. In all the other measures, Ameritech Illinois' actual performance exceeded the Commission's standards and the better company performance was adopted as the benchmark. The Commission did not impose any benchmarks that did not reflect either an established level of performance or, for out of service over 24 hours, the minimum standard provided in the rules.

Q. Do the parties generally recognize the appropriate standard?

A. Yes, they do. For example, Dr. Selwyn testifies on behalf of the City of Chicago that "The Commission did not implement the service quality component in an effort to improve Ameritech Illinois' quality, only to maintain it." (Chicago Ex. 1.0, pp. 66-67, emphasis in original). Mr. McClerren takes a similar position. (Staff Ex. 8.0, p.5)

Q. Do the parties consistently apply that standard in their proposals regarding changes to the service quality component of the Alternative Regulation Plan?

A. No, they do not. As I will discuss below, both Ms. Jackson (on behalf of Staff), to some extent, and Ms. TerKeurst (on behalf of GCI), to a much greater extent, propose service quality standards that are far more stringent than any established level of Company performance or any existing Commission rule. Those proposed benchmarks cannot be squared with the statutory goal of maintaining, rather than improving, service quality. If the goal of the plan is to maintain, rather than improve, service quality, the specific benchmarks for any new service quality measures should be based

either on established service levels, or on the minimum standards in the Commission's rules (if established service levels fall below those standards).

Q. Please summarize Ameritech Illinois' position regarding Staff's proposal relative to service quality.

A. Ameritech Illinois agrees to much of Staff's proposal, with certain modifications.

First, Ameritech Illinois agrees with Staff that service quality incentives should be removed from the PCI calculation.

Second, Ameritech Illinois agrees with most of Staff's proposal concerning changes to the existing service quality measures. Ameritech Illinois agrees that all of staff proposed additions to the service quality measures addressed by the Alternative Regulation Plan are appropriate, with the exception of abandoned calls.

However, Ameritech Illinois disagrees with Staff's proposed benchmarks for the new measures, because they do not approximate either established levels of performance or the levels required by existing Commission rules.

Therefore, they are inconsistent with the statutory goal of maintaining, rather than improving, service quality.

Ameritech Illinois would agree to benchmarks for those measures that appropriately track actual performance and/or the Commission's rules. Such an approach is consistent with what the Commission found appropriate in establishing the service quality component of the PCI in its Docket 92-0448 Order. Ameritech Illinois disagrees with Staff's proposal to change the manner in which installation within five business days is calculated, and with Staff's proposal to add a new measure for abandoned calls.

Third, Ameritech Illinois agrees with Staff's proposed deletions from the service quality standards in the Alternative Regulation Plan.

Finally, Ameritech Illinois agrees with much of Staff's proposed remedy plan, with certain modifications.

All of this is discussed in more detail by Mr. Hudzik.

Q. Please summarize Ameritech Illinois' position regarding Staff's proposed penalty structure.

A. Ameritech Illinois agrees that service quality should be removed from the PCI calculation and that the payment of penalties should be directed toward the customers most affected. However, as described in more detail by Mr.

Hudzik, Ameritech Illinois believes Staff's proposal should be modified in several ways ? some of which will primarily benefit end users and some of which will also benefit Ameritech Illinois.

First, for installation and repair delays, Staff proposes that Ameritech Illinois should compensate customers only in months in which it has missed the service quality objective in the Alternative Regulation Plan. Ameritech Illinois believes such month-to-month variation of credits would be dissatisfying and confusing to customers and also would be difficult to administer. Instead, Ameritech Illinois proposes that, for an entire year following any year in which the installation and/or repair benchmarks are missed, all affected customers should receive credits.

Second, Ameritech Illinois also agrees with Staff's proposal relative to a credit for each missed installation or repair appointment. Ameritech Illinois also supports customer credits for installation and repair delays, but believes that the Commission's proposed credits should be capped at a level that adequately compensates customers for their loss of service, but does not provide a windfall for customers.

In cases of extended installation delay, for example, Staff's proposed penalty of \$25 per day, without a cap, could result in credits far out of proportion to the value of service.

Third, Ameritech Illinois disagrees with Staff's proposed monthly credit of \$2.25 to all customers, and suggests that the Commission instead adopt Staff's alternative proposal for a \$4 million annual "penalty," when Ameritech Illinois fails meet appropriate standards for operator answering, repeat trouble reports, and business and repair office answering. However, Ameritech Illinois believes this should be done outside the price cap, as a customer credit.

- Q. Please summarize Ameritech Illinois' position regarding the GCI proposal.
- A. Like Staff, GCI proposes that service quality be removed from the PCI calculation. In addition, GCI proposes many of the same new service quality measures and benchmarks as Staff. Ameritech Illinois can agree to those proposals, to the extent noted in the context of the Staff proposal.

However, as Mr. Hudzik explains further, many of the other GCI proposals for additional measures and/or benchmarks go far beyond what is required to maintain and assure acceptable service quality. It should be the goal of all parties—Ameritech Illinois, the Commission, and GCI—that service levels be maintained. Ameritech Illinois feels its revised proposal, which closely tracks with Staff's proposal, achieves this goal. However, it appears that the goal of the GCI proposal, filled with numerous unneeded standards, unrealistic benchmarks, onerous penalties, and burdensome reporting, is one aimed at punishment of the Company, rather than looking at the statutory objective for an Alternative Regulation Plan for customer expectations.

Q. Do you agree with the increased and more detailed service quality reporting requirements proposed by GCI?

A. No, I do not. The additional reporting requirements proposed by Ms. TerKeurst are clearly contrary to one of the statutory goals of an Alternative Regulation Plan - "to reduce delay and costs over time." (220 ILCS 5/13-506.1 (a)(1)). In addition, as Mr. Hudzik explains, these additional reporting requirements would create significant management and administrative burdens for

Ameritech Illinois, with little or no benefit to customers.

PRICING FLEXIBILITY

- Q. Mr. Koch and GCI object to any additional pricing flexibility for services included in the Plan. (TerKeurst at 44-46) (Koch at 31-32, 35-36) Is increased pricing flexibility necessary for Ameritech Illinois?
- A. Yes, Ameritech Illinois needs more pricing flexibility than was contained in the original Plan because competition has developed strongly during the Plan and is growing vigorously as described in Dr. Harris' direct and rebuttal testimony. There is general recognition by GCI of the need for additional pricing flexibility. Ms. TerKeurst states "I agree that some amount of pricing flexibility is desirable, so that Ameritech Illinois can respond to changes in the marketplace and gradually restructure rates if they are not economically rational."¹ However, Staff and GCI have raised some concerns relative to Ameritech Illinois' proposal to increase pricing flexibility by 1) increasing the allowable pricing

¹ TerKeurst Direct GCI Exhibit 1.0 page 45 lines 17-18.

adjustment to 15% and 2) consolidating the four current baskets to a single basket.

Q. What specific concerns have been raised by Staff and the Intervenorors about a 15% limit on price increases and establishing a single basket?

A. Ms. TerKeurst (at 46) and the Staff (Staff 13.0 pages 35-36) are concerned with the combined impact of 15% price increases and a single basket on the residential prices. The Staff (Staff 13.0 pages 31-32) raises two concerns about the single basket. First, Staff is concerned about different classes of customers being discriminated against. Second, Staff is concerned about retail and wholesale services being in the same basket.

Q. Are you proposing some changes in Ameritech Illinois' pricing flexibility proposal to address the concerns relative to the 15% pricing increase limit?

A. Yes. I am proposing two alternatives depending upon whether the Commission adopts Ameritech Illinois' rate rebalancing proposal. The first alternative assumes the rate rebalancing proposal is accepted. In this case, Ameritech Illinois would agree to limit any price increases on included rate elements to 5% per year over

existing levels. As stated in my direct testimony, one reason for pricing flexibility increases is to allow residence access lines to be priced at least at LRSIC plus shared cost. If Ameritech Illinois' rate rebalancing is approved, these rates will be approaching cost, so further necessary price adjustments can be managed without a need for a full 15% limit.

The second alternative assumes the rate rebalancing proposal is not accepted. Under that scenario, the limit for any rate element must be at least a 10% increase per year over existing rates, but Ameritech Illinois would agree to limit the increase for any individual service to a maximum of 30% over the next five years. This would allow most services to be brought to or near cost, albeit over a longer period than our original 15% proposal.

These two proposals retain the essential pricing flexibility features while addressing the concerns of the Staff and intervenors.

Q. Will a single basket lead to discrimination against different classes of customers?

R. No, it will not. Part of the purpose of a single basket is to rectify past price differences between basic residential services and other services, which are

providing support to residential rates. Therefore, a single basket will lead to reducing current class discrimination, not introducing it. Furthermore, the Ameritech Illinois proposal I just addressed, which will limit pricing flexibility, significantly reduces the amount of allowable price increases, while still giving Ameritech Illinois flexibility to respond to competitors and to align its prices in preparation for a fully competitive market.

- S. Please respond to Staff's concern that wholesale and retail services will be in the same single basket.
- T. That won't happen because the Ameritech Illinois plan removes wholesale services from price cap regulation. Wholesale prices are set through other regulations that make price cap regulation unnecessary. Therefore, wholesale prices will not be under price cap regulation and will not be included in a basket with residence services.
- U. Dr. Selwyn (at Ex 1.0 pages 60-71) raises several "anticompetitive" concerns. Would you address these concerns?

V. Yes. The first concern expressed by Dr. Selwyn is that Ameritech Illinois would set prices without regard to their relationship to cost. This is not so. Ameritech Illinois has a continuing obligation to file its LRSICs with its annual filings or when individual tariff filings are made for services in the Plan. Therefore, Staff and the Commission are able to make rate/cost comparisons for rate changes proposed by Ameritech Illinois. This also gives the Staff and Commission the ability to assure that no price reductions are proposed which would cause the rate for any individual service to go below LRSIC, which is precluded under the Revised Plan (Schedule 1).

In the second and third concerns, Dr. Selwyn suggests that Ameritech Illinois could reduce the price of a service just before declaring that service competitive and then offset that decrease with an increase in rates for other services remaining under price regulation. While Dr. Selwyn is correct that his scenario is possible, this is not a new possibility. Under the current plan, Ameritech Illinois could have reduced service prices just before declaring them competitive. These reductions could have created headroom that would have allowed Ameritech Illinois to avoid the annual x-factor reductions. So while Dr. Selwyn has raised a

speculative scenario, it is one that has no basis in fact. Ameritech Illinois has not attempted to do something such as this in the past and in fact, had they tried to do so, such an action would likely have come under close scrutiny by the Commission and Staff.

Alternatively, Dr. Selwyn suggests that Ameritech Illinois could raise the price just before declaring a service competitive. Since any increase in prices would have to be offset by a decrease in prices in other services that remain under price caps, Dr. Selwyn's hypothetical scenario is the exact opposite of the above scenario and would result in lower prices for those services. Dr. Selwyn's unique logic is that both lowering and raising prices for non-competitive services is harmful to consumers.

Dr. Selwyn's fourth concern is that without a basket structure it is not easily possible to determine how Ameritech Illinois is affecting any particular customer class. This concern is unfounded, however. Even under the current basket structure, residential services are included in both basket 1 and basket 4. However, Ameritech Illinois files a spreadsheet listing all of the services as part of its annual filing, so the impact on

any customer class can be determined by simply adding together the changes for the appropriate services. Since this concern can be resolved by adding a few numbers, there is no need for it to be a determination of the basket structure.

Finally, although Dr. Selwyn claims that Ameritech Illinois' plan would be anticompetitive, his modifications to the plan would discourage, not foster, competition. GCI recommends lower prices for most services, particularly residential prices. As discussed by Dr. Harris and Mr. Gebhardt, such price decreases would reduce competitors' interest in entering the telecommunications market in Illinois, especially for residential customers.

- Q. Staff (Staff 13.0 pages 34-35) presents an alternative method for computing the API for the combined basket. Do you agree with their computation?
- A. Staff used the price cap revenues and indices as filed in the April 1, 2000 annual filing. Mr. Koch should have used the revenues and indices from the July compliance filing, which was filed in response to the Commission's Order in Docket 00-0260, relating to the April 1, 2000 annual filing. However, Ameritech Illinois is willing to

use his method of computation after the 911, access, and resale services have been removed from the price cap baskets, and I have revised my Schedule 1 accordingly. Schedule 2, attached, shows these computations.

Q. Ms. TerKeurst (at 46) suggests that the cap on basic residential service be extended. What is your response?

A. I absolutely disagree. This cap was legislatively mandated for the first three years of the plan and extended by the Commission for two additional years. The purpose was to provide price protection for residential customers at the outset of this new regulatory regime. However, now that the plan has proven successful, there is no reason to reinstate this cap which has already expired. In fact, as discussed by Mr. Gebhardt and Mr. Sorenson, prices for some basic residential services, which have not changed since 1990, need to be increased in order to fully recover their costs. In addition, Dr. Harris presents strong evidence that the residential rates need to be increased to be equitable and to allow competition to grow vigorously in the residential market, as it already has in the business market.

PRICE INDEX FORMULA

Q. Is Ms. TerKeurst's defense of the Commission's approval of only negative exogenous changes valid?

A. No. It is important that the exogenous changes be applied equitably to both positive and negative exogenous changes even though the Commission has to date approved only the negative exogenous changes that would reduce prices.

Q. Is Ms. TerKeurst correct to be concerned about the immediate flow through of Commission ordered changes?

A. No. In particular, the Commission should recognize any mandated reduction in rates outside price caps as positive exogenous changes to allow equitable treatment for Ameritech Illinois. The Staff agrees. It states "the Commission allows the Company to file for an exogenous change within 30 days of such revenue reduction." (Staff Ex. 2.0 p.12)

Q. Is there anything about Ameritech Illinois' exogenous factor proposal that is one-sided (Selwyn at 57-58)?

A. No. The ability to apply exogenous changes to the PCI after a Commission order rather than wait for the next

annual filing is appropriate and would apply to both negative and positive exogenous changes.

Q. How do you respond to the Staff's difficulties in reviewing the API computation?

A. This concern was raised in the last annual filing and has been resolved by Commission order. The ICC Order in Docket No. 00-0260 issued on June 27, 2000 states on page 7:

"In future filings, IBT shall provide documentation of the changes to the API that occur during the course of the year and shall do so in its initial comments. The information/documentation should take a form similar to Attachment 4 of IBT's reply comments. IBT shall also include the recalculation of the proposed and current revenue for each time the API changes over the course of the year, similar in form to Exhibit 5 of its initial comments."

Q. Dr. Selwyn (CGI 3.0 at 37-41) proposes a one-time adjustment of 4.8% for merger savings. Is his adjustment appropriate?

A. No, because his proposal is in conflict with the order in the merger savings docket. Dr. Selwyn's proposal is based on forecasts of the merger savings. His same proposal was made and was rejected in the Merger Docket 98-0555. In contrast, my proposal, described in my

direct testimony, is based on actual savings as specified in the Merger Order.

Q. What is the Staff's position on the Merger Savings?

A. Staff (Staff Ex. 4.0 pages 8-10) recommends that the final computation of merger savings be deferred until the next review of the Plan. Staff cites delays in completing the audits necessary to capture the merger-related costs and savings as the reason for the delay. It would appear to me that Staff may be deferring any permanent flow through of the net savings until the completion of the next review of the Plan and envisions the employment of an army of auditors to continually review the Company's merger savings value over an unreasonably extended time frame. Such activity is costly, time consuming, and puts customers on hold for their "advertised" benefits. In my view, it's a problem for competitors too, for not only will they not know the Company retail prices against which they will compete, they also may not be certain of price breaks that may come their way for network elements they purchase from Ameritech Illinois.

Q. What is your response to the Staff's position?

- A. The net saving should be based on 2002, pursuant to the Merger Order. At that time the net, actual merger savings will have been realized and the customers' share can be passed on. To wait longer would not be in either the customers or Company's best interest. Also it will be more difficult to identify what savings are merger related and what savings are as a result of external changes as more time passes. Moreover, there is no need to litigate this issue again. However if Staff feels that the 2002 net savings cannot be completed in time for inclusion in the 2003 annual price cap filing, Ameritech Illinois would support a separate filing after the 2003 annual filing. The merger-related savings could be passed along to customers outside of the annual filing as I have proposed for other exogenous changes.

REPORTING REQUIREMENTS

- Q. What is your opinion of excluding AADS investment in the reporting requirements as suggested in TerKeurst(at 72-82)?
- A. There is no reason to exclude AADS investment. As explained by Mr. Jacobs, investments made by AADS,

including for such services as Project Pronto, bring innovation to customers of Ameritech Illinois, as well as allowing competitive carriers to utilize the network to bring their own innovative services to end users. This is one of the goals of Alternative Regulation ? to spur innovation.

Obviously, it is possible to exclude AADS investment in any infrastructure reporting requirements. However, in subsequent reviews, the amount of innovation that can be attributed to Ameritech Illinois would be significantly reduced. Ameritech Illinois would be willing to exclude AADS investment from reporting, with the understanding that it would be unreasonable for the Commission or the parties to expect innovation in advanced services such as DSL for Ameritech Illinois.

- Q. Please comment on Ms. TerKeurst's discussion of infrastructure reporting requirements (TerKeurst at 81-82).
- A. While I still feel that any infrastructure investment or reporting requirement is duplicitous with the merger requirements, Ameritech Illinois would be willing to provide another copy of the infrastructure report provided pursuant to the merger order as part of the

Alternative Regulatory reporting requirements if that would assist the Staff.

- Q. Please comment on continuing the financial and other reporting requirements suggested by Ms. TerKeurst (at 83-84).
- A. One purpose of Alternative Regulation is to eliminate the necessity for continued oversight of a company's financial performance as is done under rate-of-return regulation. To require such financial reporting would be burdensome to the Company and would not be consistent with a goal of alternative regulation to reduce the costs of regulation.

REVIEW OF THE PLAN

- Q. Do you agree with Dr. Selwyn (at Chicago Ex 1.0 pages 72-73) and Ms. TerKeurst (at 84) that periodic reviews of the Plan should be scheduled?
- A. No. As stated in my direct testimony, there is no reason to schedule a future review at this time. It would be especially unnecessary to have such a review as soon as March 2004 as suggested by Ms. TerKeurst (at 84), with a filing in 2003. The Plan, with any revisions, will have

been in place for less than two years by then. If there should be some need for a review in the future, the Commission can schedule a review on its own initiative or at the request of any party, if appropriate. There is no need to try to predict future events at this time and schedule a specific review date.

CONCLUSION

Q. How would you summarize your testimony?

A. Ameritech Illinois is presenting a Plan that continues the benefits of price regulation to consumers, while preparing for a transition to a competitive marketplace. Several modifications of Ameritech Illinois' original proposal have been made to address the concerns raised by the Staff and intervenors where these changes are appropriate. In contrast, Ameritech Illinois rejects many of the extreme recommendations of the intervenors, who have generally pursued an objective of rate reductions, more regulation, and more reporting, all of which are contrary to the goals of Alternative Regulation. In addition, these proposals would stifle competition and discourage investment in the

telecommunications infrastructure in Illinois by both
Ameritech and other carriers.

Q. Does that complete your rebuttal testimony at this time?

A. Yes, it does.